

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: June 18, 1999

March 19, 1999

Section 61--Gross Income v. Not Gross Income
61.00-00 Gross Income v. Not Gross Income
61.32-00 Indians

CC: DOM: IT&A: 3-PLR-113304-98

Legend

Nation =
Initiative =
State =
X =
Y =
College =

Dear :

This responds to your June 23, 1998, request for a ruling on behalf of eligible tribal members concerning the proper treatment of economic development grants made by the Nation. Specifically, you have asked whether economic development grants made to tribal members pursuant to Initiative are excludable from the gross income of those tribal members under the general welfare doctrine? In addition, you have asked whether the Nation has any withholding requirements under [§ 3402\(r\) of the Internal Revenue Code](#) with respect to the grants?

FACTS:

The Nation is a federally recognized tribe organized and operated under a tribal constitution approved by the Secretary of the Interior pursuant to the Indian Reorganization Act of 1934, [25 U.S.C. § 476](#). The territorial jurisdiction for the Nation, located in State, contains approximately X acres. Currently, there are Y members enrolled in the Nation, over half of which are adults.

The Nation conducts Class III gaming operations on tribal land pursuant to the Indian Gaming Regulatory Act, [25 U.S.C. § 2701 et seq. \(1988\)](#). Revenues from these operations are used to provide basic government services and are the funding source for the economic development program described below.

There are relatively few member-owned and operated businesses within the Nation. Statistics indicate that in 1996 the Nation had an unemployment rate of more than 79 percent. More than 60 percent of the Nation's households earned incomes below the poverty level. The Nation represents that one of the major obstacles to business development within the Nation is the inability of members to obtain financing for business ventures. Of primary concern to lenders is their inability to obtain a security interest in tribal lands because the lands are held in trust by the United States and are exempt from security interests or other incumbrances that would normally serve as collateral for loans.

The Nation represents that, to the best of its knowledge, no member has been able to obtain a loan from a commercial lender for a business venture within the Nation's boundaries.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, [P.L. 104-193](#), also known as the Welfare Reform Act, ended Aid to Families with Dependent Children (AFDC) and replaced it with a federal block grant program for use by state or tribal governments to provide Temporary Assistance to Needy Families (TANF). The Nation's TANF Plan states that while providing temporary assistance to needy families, the Nation must foster business development. The TANF Plan contemplates that the TANF recipients will receive the necessary means and training for self-sufficiency and personal responsibility through other programs administered by the Nation such as the Business Grant Program.

In 1997, Initiative was passed by members of the Nation which provided for the distribution of certain of the Nation's gaming revenues. Due to the Nation's conclusion that there is a lack of business development within the Nation that would provide employment to those members now on public assistance, Initiative contains a provision establishing an economic development plan. Pursuant to the economic development plan, a seven member Economic Development Task Force has been created. It is the responsibility of the task force to promote economic development for the Nation by attracting to the reservation and creating both large and small businesses to employ tribal members.

The Initiative also established an Economic Development Department which is subject to oversight by the Economic Development Task Force. All overhead costs of the Department are funded by gaming revenues. The Department staff currently consists of a director, administrative assistant, secretary, and three economic development specialists, one of whom will focus primarily on educational training programs for grant applicants and grantee businesses. The Initiative establishes funding for the Business Grant Program that provides grants to individual members of the Nation for business development. Grants from \$5,000 to \$100,000 are available under the Business Grant Program to individuals who are enrolled members of the Nation. The \$100,000 limit also will be applied to any single venture regardless of the number of individual members participating in the venture. The purpose of the Business Grant Program is to improve the general welfare of tribal members by providing small business financing to entrepreneurs who would otherwise be unable to find start-up capital for new ventures and expansion capital for existing businesses. The Nation states that the long-term impact is expected to be a stable base of independently owned small businesses.

To apply for a grant under the Business Grant Program, a member of the Nation must submit a letter of intent and a business plan. The business plan must include information indicating the ownership and form of organization of the business, narrative description of the business, qualifications of the owner to operate the business, results of market studies, production and operating plans, cost studies, operating cash and profit projections for three years including a detailed statement of sources and uses of funds in the business startup, legal requirements for the business and evidence that they have been satisfied, implementation time table for business start-up, and proposed measures of performance for the business.

The Economic Development Department will provide technical assistance to members and help them prepare grant proposals and business plans. An agreement will be formalized with College to provide its credit courses directly to grant applicants at sites within the Nation. College has developed a detailed sample curriculum through its Small Business Development and Training Center for members of the Nation. Members are required to complete a business planning training course approved by the Economic Development Task Force to be eligible to receive a business grant.

Once a member submits a letter of intent and business plan, the Economic Development Task Force will evaluate the proposal according to the following formal criteria: location, expected contribution to the local economy of the Nation, and the degree of need of the business owner. First priority for grants will be assigned to those individuals whose

businesses will be physically located in the territorial jurisdiction of the Nation. Additional priority will be assigned to individuals whose proposals for businesses are expected to directly employ members of the Nation, purchase goods and services from members of the Nation, and attract investment of outside resources to the Nation. In evaluating the need of the individual business owner, priority will be assigned to individuals who do not have sufficient personal resources to finance the business enterprise and to those individuals who demonstrate that they cannot find other, outside financing for the business. The Nation does not anticipate awarding any grants to members who can provide sufficient funding on their own.

Once a grant is awarded, the member and the Nation will enter into a formal agreement for disbursement and use of the funds. The Grant Agreement will specify obligations of the grant recipient including use of the funds according to the business plan, and reporting and performance standards. The Grant Agreement will specify that the grantee cannot sell the business or its assets during the term of the Grant Agreement. The Grant Agreement also will specify special conditions and remedies for nonperformance. For example, funds not expended in accordance with the Grant Agreement are repayable by the grantee in full with interest and costs.

LAW & ANALYSIS:

[Section 61 of the Internal Revenue Code](#) states the general rule that gross income means all income from whatever source derived. Generally, all income is subject to taxation unless excluded by law. [Commissioner v. Glenshaw Glass Co., 348 U.S. 426 \(1955\)](#).

Individual tribal members are citizens of the United States and are subject to federal income tax, unless specifically exempted by treaty or statute. See [Rev. Rul. 67-284, 1967-2 C.B. 55](#), modified on another issue by, [Rev. Rul. 74-13, 1974-1 C.B. 14](#), [amplified by, Rev. Rul. 94-16, 1994-1 C.B. 19](#), [amplified by, Rev. Rul. 94-65, 1994-2 C.B. 14](#).

The Service has held that payments made under legislatively provided social benefit programs for promotion of the general welfare are excludable from gross income. This general welfare doctrine applies only to governmental payments out of a welfare fund based upon the recipients' need, and not as compensation for services. See e.g., [Rev. Ruls. 57-102, 1957-1 C.B. 26](#) (payments to the blind), 74-74, [1974-1 C.B. 18](#) (awards to crime victims or their dependents), 74-205, [1974-1 C.B. 20](#) (replacement housing payments to aid displaced individuals and families), 75-271, [1975-2 C.B. 23](#) (assistance payments for lower income families to acquire homes), 98-19, [1998-15 I.R.B. 5](#) (relocation payments made to flood victims).

On the other hand, the Service has stated that benefits payable regardless of the financial status, health, educational background, or employment status of the recipient are not excludable under the general welfare doctrine. See e.g. [Rev. Rul. 76-131, 1976-1 C.B. 16](#) (equal payments made regardless of financial status, health, educational background, or employment status, to persons over 65 who have lived in Alaska for 25 years, are includible in gross income of recipients). See also [Bailey v. Comm'r, 88 T.C. 1293 \(1987\)](#), acq. On another issue, 1989-1 C.B. 1, [Bannon v. Comm'r, 99 T.C. 59 \(1992\)](#).

[Rev. Rul. 77-77, 1977-1 C.B. 11](#), addresses the treatment of nonreimbursable grants made to Indians under the Indian Financing Act of 1974. The revenue ruling states: Title IV of the Act, entitled *Indian Business Grants*, was established by Congress for the purpose of stimulating and increasing Indian entrepreneurship and employment by providing equity capital through nonreimbursable grants made by the Secretary of the Interior to Indians and Indian tribes to expand profit-making Indian-owned economic enterprises on or near reservations.

Payments made under legislatively provided social benefit programs for promotion of the general welfare are not includible in a recipient's gross income. See, for example, [Rev. Rul. 74-205, 1974-1 C.B. 20](#), and the Revenue Rulings cited therein; see also [Rev. Rul. 75-271, 1975-2 C.B. 23](#), holding assistance payments made to the mortgagee on behalf of low income homeowners by the Department of Housing and Urban Development

pursuant to section 235 of the National Housing Act, as amended, are not includible in the gross income of the individual homeowners since such payments are in the nature of general welfare.

Held, grants made pursuant to Title IV of the Act are excludable from gross income for Federal income tax purposes.

Title IV of the Act, addressed in the revenue ruling discussed above, sought to stimulate and increase Indian entrepreneurship and employment by providing equity capital through nonreimbursable grants of up to \$50,000 to Indians to expand profit-making Indian-owned economic enterprises on or near reservations. Title IV was amended in 1984 to increase the maximum grant amount to \$100,000 per Indian. Under the Act, recipients had to show that they could not obtain adequate financing from other sources. In addition, recipients had to show that they could obtain at least 60% of the necessary funds from other sources, including their personal assets.

In the present case, a tribal government proposes to make grants to eligible tribal members for the purpose of increasing Indian entrepreneurship and employment by providing equity capital through nonreimbursable grants to tribal members for new ventures and expansion capital for existing businesses. That purpose is similar to the federal government's purpose [under the Indian financing Act of 1974. See Rev. Rul. 77-77](#). As in the federal program addressed in [Rev. Rul. 77-77](#), recipients of grants under the Nation's program cannot obtain adequate funding from other sources, including their personal assets. Also similar to the program addressed in the revenue ruling, the Nation's program gives priority to individuals whose businesses are physically located in the territorial jurisdiction of the Nation. In addition, recipients will be required to return any funds not expended as agreed in the grant application.

[Rev. Rul. 77-77](#) states that payments made under legislatively provided social benefit programs for promotion of the general welfare are not includible in a recipient's gross income. In the present case, the registered voters of the Nation passed Initiative, which established several programs for the general welfare of the tribe, including the Business Grant Program. The facts indicate that the Nation has an unemployment rate of over 79 percent and that more than 60 percent of the Nation's households earned income below the poverty level. The Business Grant Program gives priority to individuals whose businesses are physically located in the territorial jurisdiction of the Nation, and assigns additional priority to individuals whose businesses directly employ members of the Nation, purchase goods and services from members of the Nation, and attract investment of outside resources to the Nation. Therefore, the payments made under the Business Grant Program to tribal members who both 1) cannot obtain adequate financing from other sources, including their own personal assets and 2) use the grant to develop or expand a business that is physically located on or near the territorial jurisdiction of the Nation are part of a legislatively provided social benefit program for the promotion of the general welfare. Thus, we conclude that economic development grants made pursuant to Initiative to tribal members who meet both 1) and 2) are excludable from the gross income of those tribal members under the general welfare doctrine.

[Section 3402\(r\)](#) of the Code extends the withholding provisions to certain taxable payments of Indian casino profits. The business grants at issue are not taxable payments of casino profits. Thus, the Nation does not have a withholding requirement under [§ 3402\(r\)](#) with respect to the business grant amounts.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in

support of the request for rulings, it is subject to verification on examination.

Sincerely,

Assistant Chief Counsel (Income Tax & Accounting)
Michael D. Finley
Chief, Branch 3

This document may not be used or cited as precedent. [Section 6110\(j\)\(3\) of the Internal Revenue Code](#).

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